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IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

BARCLAYS BANK PLC,
Petitioner,

v.

FRANCHISE TAX BOARD,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of California

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a non-profit association, which was originally organized in 1969 as an advisory committee to the Council of State Cham-

bers of Commerce. COST, which was separately incorporated January 1, 1992, has a membership of 372 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Virtually all COST member companies are engaged in business in the State of California, either directly or through subsidiary operations, and are subject to that State's corporate income tax. COST member companies include a substantial number of corporations that are owned by non-U.S. corporations. A significant number of COST member companies are engaged in business in jurisdictions outside the United States and would be subject to retaliatory actions by such countries should worldwide combined reporting be upheld. Therefore, COST clearly has an interest in the instant case, in which the constitutionality of California's imposition of worldwide reporting on foreign parent unitary groups is at issue.[1]

SUMMARY OF ARGUMENT

The State of California's imposition of worldwide combined reporting has been the subject of Foreign Commerce Clause challenges for over twenty years. Although this reporting method, as applied to domestic parent groups was upheld in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court explicitly reserved the specific question at issue in this case, that is, whether worldwide combined reporting as imposed on a foreign parent unitary group violates the Foreign Commerce Clause. 463 U.S. at 189, fn. 26. Not only does this

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[1] Worldwide combined reporting, the method used by California to apportion the income of multinational corporations, and the arm's length separate accounting method, which is used by the United States and its foreign trading partners to allocate such income, are explained by petitioner in its Petition for Writ of Certiorari, at page 5.

case raise the issue reserved by the Court in *Container*, it also presents certain facts that the Court emphasized as missing in *Container*. The tax at issue in this case falls on a foreign entity, 463 U.S. at 195, the Federal Government has filed *amicus* briefs during the litigation in the California courts expressing its opposition to worldwide combinued reporting, 463 U.S. at 195-196, and this Court no longer has to guess at the risk of retaliation by foreign nations, 463 U.S. at 194, as the offense to our foreign trading partners has been clearly expressed by the United Kingdom's enactment of retaliatory legislation. Thus, nine years after *Container*, this Court is finally presented with a fully developed opportunity to answer the question left open in that case.

Moreover, the decision of the California Supreme Court, holding that "governmental silence" evidences Federal approval of worldwide combined reporting (or any other state policy implicating foreign relations) sets a precedent that is contrary to this Court's Foreign Commerce Clause jurisprudence as developed in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), *Container*, *supra*, and *Wardair Canada v. Florida Department of Revenue*, 477 U.S. 1 (1986).

Because of the implications of the decision of the California Supreme Court for the Federal Government's ability to conduct foreign policy; the importance of the issue to the states and to a large number of taxpayers, as well as foreign governments; and in consideration of the long period that this issue has been pending, this Court should grant the petitioner's petition for writ of certiorari.

ARGUMENT

THIS CASE PRESENTS THE APPROPRIATE VEHICLE TO DECIDE THE FOREIGN COMMERCE CLAUSE ISSUE SPECIFICALLY LEFT OPEN BY THIS COURT IN *CONTAINER*, WHICH HAS BEEN THE SUBJECT OF LITIGATION FOR THE NINE YEARS SINCE THAT DECISION AND WHICH HAS ENORMOUS IMPACT ON THE FEDERAL GOVERNMENT'S ABILITY TO FORMULATE FOREIGN TRADE POLICY.

Article I, § 8, cl. 3 of the United States Constitution reserves to Congress the power to regulate commerce with foreign nations and among the states. This Clause, "by its own force created an area of trade free from interference by the States" and "even without implementing legislation by Congress is a limitation upon the power of the States." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 328 (1977). With regard to foreign commerce, the "constitutional prohibition against state taxation . . . is broader than the protection afforded to interstate commerce . . . because matters of concern to the entire Nation are implicated." *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, —— U.S. ——, 112 S. Ct. 2365, ——, 60 U.S.L.W. 4582, 4584 (1992). Thus, in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court stated that "[f]oreign commerce is preeminently a matter of national concern," 441 U.S. at 448, and held that a state tax violates the Foreign Commerce Clause if it "impair[s] federal uniformity in an area where federal uniformity is essential." 441 U.S. at 448.

In *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court elaborated on the "one voice" requirement of *Japan Line*, stating that where foreign affairs are implicated, the "one voice" standard is violated if the state tax "*either* implicates foreign policy issues which must be left to the Federal Government *or*

violates a clear federal directive." 463 U.S. at 194 (emphasis in original). This Court went on to state that "[t]he most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.*

In *Container*, this Court felt that it could not determine when a foreign nation might be offended by a state tax policy. *Id.* However, one no longer has to speculate about whether foreign trading partners are so offended by worldwide combined reporting that retaliatory actions might be taken. In 1985, the United Kingdom enacted retaliatory legislation that would deny certain tax credits provided by the United States/United Kingdom Income Tax Treaty to United States corporations doing business in a state imposing worldwide combined reporting.[2] Finance Act of 1985, section 54, recodified as Section 812 of the Income and Corporation Taxes Act of 1988. Although the United Kingdom has not yet triggered this provision, as this Court recognized in *Japan Line*, "[t]he risk of retaliation . . . under these circumstances, is acute, and such retaliation of necessity would be felt by the Nation as a whole." 441 U.S. at 450.[3] The risk is all the

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[2] Under the United States/United Kingdom Income Tax Treaty, a United States corporation receives a refund of certain amounts of taxes withheld by a United Kingdom payor on dividends paid by that payor. United States corporations are entitled to this refund for taxes paid on dividends received from U.K. subsidiaries or investments of at least 10% in unrelated U.K. corporations.

[3] The impact of the United Kingdom's retaliatory statute is not limited to California based corporations. The statute denies the refund otherwise due a United States corporation under treaty if the U.S. corporation or one of its affiliates has a "qualifying presence" in California. Income and Corporations Taxes Act of 1988 ("1988 Act") section 812(1). The United Kingdom may, at its discretion, consider a company to have a qualifying presence within California simply if it is subject to tax by the State, 1988 Act, section 812(7), or if the corporation has relatively small property, payroll or sales in California. 1988 Act, section 812(3). There-

more acute in the face of the decision of the California Supreme Court upholding the constitutionality of worldwide combined reporting as imposed upon a unitary group whose parent is a United Kingdom corporation.[4] As this Court stated in *Japan Line*, "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." 441 U.S. at 453. The Foreign Commerce Clause issue presented in this case is of such importance to international trade and the retaliatory threat to domestic corporations so immediate that it must not be left unanswered any longer. *See, Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 485-486 (1975).

Taxpayers have challenged worldwide combination on Foreign Commerce Clause grounds since the State of California began enforcing this form of taxation. *Container* involved tax years 1964 through 1966 and although the State's tax assessments were issued in 1969, the final determination in that case was not rendered until this Court's decision in 1983. The dispute in *Barclays*, which involves the 1977 tax year, was pending during the *Container* litigation and nine years later, fifteen years after the tax year at issue, the Court finally has an opportunity to end this unduly drawn-out process for the taxpayer and to answer the question it left open in *Container*. As the Franchise Tax Board pointed out in both

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fore, a corporation doing business in every state except California and which receives dividends from investments in U.K. corporations, may face a greatly increased U.K. tax burden if it is affiliated with a corporation with minimal contacts with California.

[4] In *Unitary Tax: Review of Progress Towards Resolving the Problems*, a Joint Report by Inland Revenue and the U.S. Treasury, issued in December, 1991, the United Kingdom reviewers concluded that, pending settlement of the issue of the constitutionality of worldwide combined reporting through litigation, the United Kingdom "should maintain its retaliatory legislation on the statute book, giving no further guarantees as to whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it." ¶ 7.2.a.

its Petition for Review and Brief on the Merits in the California Supreme Court, *Barclays* is the "test case" with regard to foreign parent unitary groups. Petition at 2, n.1, Brief at 5, n.6. This case affects not only Barclays, but also the large number of other taxpayers waiting for a final determination of the issue of whether worldwide combined reporting as imposed on foreign parent unitary groups violates the Foreign Commerce Clause. It is time that these taxpayers, who have held their cases in abeyance pending the *Barclays* test case, receive an answer.[5]

The decision of the Califorina Supreme Court, if left unreviewed, also creates a dangerous precedent through its misapplication of *Wardair Canada v. Florida Department of Revenue*, 477 U.S. 1 (1986). According to the decision of the California Court, Congressional ratification of worldwide combined reporting is evidenced by the fact that Congress has not, either in a committee or in the full House or Senate, voted on legislation preventing such a state tax on foreign commerce.[6] However, this

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[5] The number of affected taxpayers is so large that the Franchise Tax Board was compelled to issue FTB Notice No. 89-714, on November 17, 1989, outlining the procedure to be used by taxpayers to defer cases pending a decision of the Foreign Commerce Clause issue in *Barclays*. Pet. App. G.

[6] The California Supreme Court did rely heavily on the Senate's actions in ultimately ratifying the United States-United Kingdom income tax convention without a prohibition of states' use of worldwide combined reporting. However, this was not an action that was taken by the entire Congress. Only the Senate gives its consent to foreign treaties. U.S. Constitution. Art. II, § 2. This action cannot be imputed to the House or used as evidence of *Congressional* approval of California's use of worldwide combined reporting. There is no authority to support the California Supreme Court's use of the failure of two-thirds of the Senate to ratify a treaty containing a specific provision, pursuant to its powers under Article II of the Constitution, as evidence of the intent of the majority of the Congress to approve, pursuant to Article I of the Constitution, a state tax affecting foreign commerce.

Court's decision in *Wardair* did not hold that governmental silence could foreclose a dormant Foreign Commerce Clause analysis. Rather, the Court stated that it is just such governmental silence that triggers that analysis, but that such analysis was not applicable in *Wardair* because the federal government had affirmatively acted by entering into international agreements explicitly limiting certain local tax powers. *Wardair*, *supra* at 9-10. The California Supreme Court's misreading and misapplication of *Wardair* could be used to justify any state action affecting foreign commerce where Congress has not acted, effectively destroying the protections to foreign trade provided by the dormant Commerce Clause. This broader issue, as well as the specific issue with regard to worldwide combined reporting, requires review and clarification by this Court.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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